

**THE BASIC ISSUES OF THE
HOUSING POLICY AT THE
END OF THE 90s IN HUNGARY**

Prepared for
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THE BASIC ISSUES OF THE HOUSING POLICY AT THE END OF THE 90s IN HUNGARY

In this paper I am planning to give an overview of the current issues in housing policy and to summarize the conclusions of research in the field of housing policy which has been carried out since the change in the political system. A compilation of this kind is necessarily subjective, as there are several issues in which, the experts have not come to an agreement yet. Neither theoretically, nor empirically (how to interpret data). Therefore, I indicate the disputed issues as well, where possible. I am planning to compile a relatively short material and I will refer to further literature, where it is available.

This compilation draws heavily on the work that has been going on in Metropolitan Research Institute for nearly ten years, the contributions of many of my colleagues, Iván Tosics among them, with whom we have worked together closely on several topics. The basis of this paper, however, is the work carried out within the framework of the National Housing Policy Council, financed by the United States Agency for International Development. The discussions of the expert team I am the head of have also been used in preparing this material, especially the views of *Zsuzsa Dániel and János Farkas*, whose written analyses have also contributed to this paper.

THE MACROECONOMIC CONTEXT

The Housing Situation in Hungary

The crisis of the housing sector is essentially not deeper than the crisis in other important sectors of the society. Basically, this statement can be supported through three important arguments:

International comparisons show that the macro-economic indicators of the housing situation in Hungary are not worse than the indicators in countries at a similar level of development. The housing sectors in former communist countries are not in a better situation either.

According to public surveys the housing problem has lost some of its significance and public security, health care, education etc., are at least as important.

The public attitude in the housing market, which can be assessed based on the structure of the consumption expenses in the household sector, also show that the importance of such durable goods as cars has increased compared to housing units.

Conclusions: prudent housing policy emphasizes the critical aspects of the housing sector, it does not aim at reallocating resources to the housing sector in general but its actions have the following purposes:

Setting up effective market institutions.

Addressing the issues seen as critical on the basis of social policy.

International comparisons clearly show that according to the most important statistically relevant indicators, the housing situation in Hungary is significantly good compared to other (not East-European) countries with a similar level of income and often it is not far behind the West-European countries either. In Hungary the units are not so crowded, an occupant has a larger base area on average and the size of the units per 1000 persons is larger.

Table 1
The different indicators of the housing situation around 1990 in the cities of the three country groups

Indicator	Country Group		
	Eastern Europe	Similar Incomes	Western Europe
GNP per capita (USD/year)	2,552	2,431	19,792
The proportion of units occupied by the owners (in percent)	28 (cities) 58 (villages)	62	65
The proportion of rents and incomes (in percent)	5.7	20.5	15.9
Housing prices (average units) and the proportion of incomes	9.3	4.2	4.7
Base area per capita (m ²)	19.6	14.0	32.3
Households per one unit	1.12	1.16	1.02
The number of occupants per one room	1.28	1.74	0.67
The number of occupants per one room	366	207	481
Housing construction: the number of new constructions per 1000 people	4.5	7.4	6.1
Housing investments in the percentage of GDP	3.7	6.3	3.8
The proportion of newly formed households	1.4	4.6	0.9
The yearly growth of the housing stock	2.0	4.1	1.3
Housing loan portfolio ¹³	9.7	15.6	26.2

*Unadjusted figures from the cities around 1990, partly from the comprehensive survey of the World Bank, partly from the Central-Eastern European regional housing database (MRI, 1996). The crucial factor is the attitude of the households in the market: the housing system is dominated by factors independent from the state, by the private economy.

The quantitative indicators of the housing situation show clear signs of improvement in the 90s, which can be explained not so much by the housing investments but the demographic tendencies.

Table 2

¹³ It was defined as the proportion of the value of the total portfolio of housing loans and all the outstanding loans in commercial and state banks together.

Housing situation 1970-1996

	1970	1980	1990	1996
Housing stock (in 1,000)	3,122	3,542	3,853	3,991
Residents per 100 units	318	292	263	250
Residents per 100 rooms	193	146	110	104
The number of households (in 1,000)	3,328	3,719	3,890	3,867
Households per 100 units	108	105	101	97

Source: Farkas, 1995, Mikrocensus, 1998

Housing market polarization and low housing mobility

The structure of the housing market has changed in the past ten years: the gap between the expensive and the cheap units has widened as a consequence of the changes in the selection (imported materials, abolishment of the discrimination against luxury units, rise in construction prices) and the increasing differences of income. This is a basically positive development, which has important consequences in housing policy: the system of subsidies must increasingly rely on an assessment of the income, as indirect indicators, such as the number of children, etc. are not enough to ensure adequate targeting of the subsidies. Furthermore, the regional concentration of cheap units will be an increasingly serious problem, which will aggravate not only the physical problems of the units, but also the social problems of the occupants. Regional targeting of the housing policy programs may become more necessary as well.

Seven years after the change in the political system it is still true that the system of market institutions has not been set up yet. There is a housing market, but the operation of this market is more expensive than in a housing system where these institutions exist and effectively operate. The main issue here is the creation of legislation to ensure that investments in the housing system should not be in a more disadvantageous situation than in other sectors. Implementation, guarantees and unbiased taxation are the other factors that may count. In addition, regular information on the housing market also help to reduce the operational costs of the housing system (transaction costs).

The effective operation of the market means providing information, legal security, reliable property registration, foreseeable future, institutional guarantees and consequently *low transaction costs*. Why is it, that no one knows the recent trends in housing prices, whether they have increased more on average than the inflation; how many families changed residence last year, etc. There is no reliable information available (property frauds), and the flow of information is limited even between broker firms on the real estate market.

One of the most generally accepted indicators used to describe the housing market is the unit price/income ratio. This indicator shows that how many years of income an average household needs in order to buy an average unit. This indicator is between 2.5 and 3.5 years in market economies, which is not a sign of *the level of development in the*

country, but the healthy operation of the housing market. A high level of these indicator shows that the market prices of the units - usually because of the interference, or the distortion in market conditions - are relatively high compared to the incomes. This indicator was typically high in East-European countries, as the sales prices in the recorded transactions were true only for a relatively narrow market. Where a relatively small number of generally determined the prices usually well to do households (having secondary sources of income, foreign currency savings), which were willing to pay significantly more for the units offered for sale.

It can be interpreted as a step towards a market housing system after the change in the political system. According to our estimates, in the 1990s the *unit price/income ratio* (average unit price divided by the average income of households) *dropped from 6.1 to about 4.9* (our estimate), as the increase in the incomes has been higher than in the housing prices.

However, the gap between the cheap and the expensive units has widened, the market has become polarized as the rise in the housing prices has generally been smaller than the inflation but this rise had a different pattern (nominally) in the different market segments. This is partly due to the *increasing inequalities in the incomes*. In the 80s the percentage of people living below subsistence level was about 10 percent, while in 1992 22 percent, in 1993 24 percent, in 1994 32 percent and according to estimates in 1995 it was already as high as 30 to 35 percent. The gap between the upper and the lower tenth of income also increased from 5.8 in 1987 to 7.0 in 1994. Real income has increased only in the upper income tenth, mainly at the expense of those in the middle of the income range (the share of the lower income fifth in total was relatively stable). Permanent poverty has appeared, involving 12 percent of the households (Galasi, 1995).

There are significant inequalities in the society concerning both the distribution of incomes and housing units and *these two systems of inequality overlap only to a slight extent*. The value of the housing units in the case of 20 percent of the population living in the most expensive units is 8.5 more than in the case of people living in the cheapest units. (Hungarian Household Survey, 1993). The income of the upper income fifth is 7 times as much as the income of the poorest fifth. At the same time, people living in the most expensive units earn only twice as much on average as the people living in the cheapest units. However, we can also say, that the price of units in the case of those with the highest income is twice as much as in the case of those with the lowest income. The correlation coefficient between the price of units and the income was 0.38, which is significant, and therefore suggests a connection, but not a very close one. *In other words this means that there are reserves in the sense that there are income groups with a relatively high income living in worse units and relatively low-income groups living in better units than what their income would justify.*

The transactions originated in the newly constructed units are indicators of the operation of the housing market. *According to a survey carried out in 1993 the length of*

chains originated in new construction was 1.87, which means that 100 new units bring 87 existing units to the housing market. (Hegedüs, 1994) In international comparison this figure shows a lower mobility. Similar indicators often fall between 2 and 3.5 in West-European countries. In the period between 1980 and 1985 similar studies resulted in chains between 1.3 and 1.6.

Based on the 1993 Hungarian Household Survey figures the full number of housing transactions can be estimated to be around 90 and 110 thousand (the first three years of the 90s), which means that the new housing construction multiplier is between 3 and 5.5. This multiplier, which is a quotient of the total number of housing transactions (including new construction) and the units constructed in the given year, is an indicator of mobility. This is different from chain removals, as it includes the transactions not directly connected to new units, so they are consequently higher than they are. These figures can be considered as estimates, so unfortunately there is no comparable information available.

The polarization of housing market prices had a different effect on those who buy their first units and the families active in the housing market. The relative situation of those buying their first units has improved in the market. Because of the price of low quality units, (the upkeep of which is often more expensive) has decreased in real value. In the case of those buying their first unit, a two-year average income is enough. However, in the case of families wishing to move, (who have to pay the difference between the cheaper and the more expensive units), the difference between the housing prices and the income has increased, supporting the observation that going on to live in another flat has become quite difficult.

Table 3

Housing price/income in the case of families buying their first units and the ones selling their home and buying a new one in the market (mobile families)

	1990	1996
First unit buyers	4.2	2.0
Mobile families	3.8	5.2
Average unit	6.1	4.6

We suppose that there is a 12-point difference between the prices of first units and the units purchased by mobile families, and between the rate of inflation and the growth in housing prices.

On the basis of the 1993 Hungarian Household Survey, 8 percent of the households said that they were planning to move the following year and to construct or to buy a home.¹ This would involve about 300,000 households. A study of the intentions to move broken down to income fifths showed that the difference is not really significant, which, at the same time, suggests that the income is not the most important factor concerning the intentions to move. There is a significant difference between villages and cities: in villages 5 percent of the households intend to move, while in cities 10 percent of them. To put it in another way, out of the 300,000 households intending to move², about 230,000 live in cities, 38 thousand of which falls in the lower income fifth and 70 thousand falls in the two lower income fifths. Essentially, these are the households in the city that are in disadvantageous situation.

Housing mobility is still low and housing policy lays little emphasis on it, although the rate of occupancy in the housing stock and its connection to housing modernization and housing renovations is obvious. More than 50 percent of the households changing their residence carries out some kind of renovations in their home.

Housing demand (housing as investment or service), the problem of housing investment and affordability

The demand for housing, which is based on speculation, according to our hypothesis, has fallen behind and this has contributed to the growth of the supply of existing units and to the decrease in the housing prices. Among the housing investments of households (we call this gross housing investment) we should distinguish purchase, construction, extension and renovation: all of these improve the position of the household. Housing policy experts consider only net housing investment (they do not consider

¹ It is worth mentioning that according to the Budapest Rental Housing Survey prepared at the beginning of 1995, 8.4 percent of the households intend to move in the following one or two years. Households, which have bought or are going to buy the unit they have been living in intend to move in a larger proportion than those who have not bought their unit.

² The intention to move can theoretically mean not only upward mobility, but families who wish to move downward. We have no reliable information on it, but based on our previous studies downward mobility can be estimated between 10 and 15 percent.

transactions within the housing sector) and practically forget about extension and renovation because statistics do not take these into account. After quantitative housing shortage has been abolished, the importance of housing transactions increases, since the occupancy rate in the housing stock can be improved through this and as every second transaction involves renovation and indirectly generates significant investments. 15 to 20 percent of the households are dissatisfied with their units, 400 to 500 thousand households intend to modernize and extend their units and 200 to 250 thousand intend to change residence within two years. This is a significant potential market, which is not utilized by the sector.

The basic issue in the summary of the past ten years is how macro-economic trends influenced the system of housing finance, basically through the housing sector and the supply and the demand in the housing market.

In the housing market the source of solvent demand is the income of the households, which in the case of housing investments is supplemented by housing loans and housing subsidies. The size of the housing loans, however, depends on the solvency of the households and therefore the income situation and the preferences of the households basically determine demand.

There have been unfavorable trends in the income situation of the households as a consequence of the macro-economic changes and the transformation of the economy. The decrease in the real income of households usually meant that their consumption has also decreased together with the demand for new homes (income effect). Owing to the preferences of the households, at the same time, there have been changes in the structure of consumption, which have only been intensified by the (relative) change in the prices of different goods and services.

In the past ten years the housing expenses of households decreased (at real value). The basic explanation of the smaller number of housing constructions is that demand has decreased, but besides that, it seems that housing expenses decrease to a greater extent than non-housing expenses, e.g., basic items of food. A more important tendency is, however, that among housing expenses, the proportion of the costs of upkeep and operation has increased in comparison to housing investments.

Speculative demand used to be an important factor in the housing demand in the 80s, which considered housing investments as profitable forms of alternative savings. This was strengthened by the rise in the housing prices exceeding the rate of inflation and by the lack of different alternative forms of savings producing the same result. In the past few years demand for housing units as forms of savings has dropped (there are favorable, alternative forms of investment), which is both the cause and the outcome decreasing housing prices. This factor also influences the demand, as it does not only mean that no new (speculative) demand is generated, but also that the people who bought units for speculative purposes will bring them to the market as new supply.

An important component in the housing demand is the number of households and the mobility in the given region. If the population becomes smaller and mobility in the region slows down, demand will also become smaller.

By the first half of the 90s the so-called quantitative housing shortage was abolished, that is, the number of units became higher than the number of households, indicating that the nature of the housing problem has changed in this decade.

Housing supply has been influenced by privatization as well. 650,000 units in the 800,000 housing stock were transferred to the ownership of the occupants, many of whom took the unit to the market. However, we can say in general, that as real incomes become smaller there is a strong motivation to curb excessive consumption in housing. This had a negative impact on the demand for new housing, as the households intending to buy a home were able to choose from a wider supply of existing units.

Besides this, however, there has been a change in the relative prices of new and existing housing units as the real value of subsidies for new housing has decreased and certain forms of subsidies (e.g., local subsidies) have been extended to existing housing units. The rise in the price of construction material and in the price of vacant lots (no more cheap lots) has also increased the costs of new construction, strengthening the tendencies mentioned above. These market trends have resulted in a smaller number of new housing constructions.

The indicator showing how many years of income is needed for a household with an average income to buy a housing unit with an average value is high in Hungary, between approximately 4.5 and 6.0, while in West-Europe it is between 2 and 3. Experts use different figures and a typical mistake is to compare the costs of new housing with the annual incomes. This indicator is not used in studies on the subject and it is misleading to use it together with the previous indicator.

HOUSING INVESTMENTS AND THE ECONOMIC BOOM

Housing policy experts tend to think, I think wrongly, that subsidized housing investments may result in a boom in the economy. It is often said that the subsidy provided for new housing construction pays itself back many times over from the taxes. However, what we have to do with here is usually not just the fact that subsidies can only be financed from taxes, but that these tax revenues could be used for other socially and economically important purposes as well. Studies on the economy have also questioned the hypothesis that there is a causal connection between housing investments and an economic boom. It seems that this works the other way round; if there is a boom, housing investments also increase and if there is a depression in the economy, there is a decrease in them (oversized developments).

Housing policy should start with the realization that the housing system is an integral part of the transformations taking place within the society and the economy, together with all its positive and negative consequences. The economic impacts of the housing sector can be seen in employment, production, and investments in the financial system and in the consumption of the households. Housing assets are one of the most important items of property in the household sector, consequently the economic attitude of the households is basically influenced by the housing sector. Transactions in the housing market (either new constructions or the sale of existing units) create a demand for durable consumer goods and facilitate renovations and consequently have a vitalizing impact on the economy. Therefore the trends influencing the housing sector have increasingly become a function of the decisions, interests and expectations of economic and social factors outside the housing sector. In other words, the influence of the economic and social factors on the housing sector is increasing and housing policy should facilitate this trend.

Housing policy, if it artificially intends to separate this important sphere from the whole of the economy, is mistaken. Housing finance, for example, plays a crucial role within the banking systems in modern economies and a mistaken housing finance system can cause serious problems within the economy and it is true the other way round as well and in an insecure banking system modern housing finance is not possible.

In the same way as in other sectors of the economy, cycles characteristic of the whole economy can be observed in the housing market. The overall situation of the economy influences the housing market through the inflation, the level of employment, the sales prices and the rents, the opportunities for housing loans and the intensity of construction activities. The number of sales and constructions, the amount and the frequency of the different financial obligations concerning the units and the changes in the rents clearly indicate the cycles in the housing market. The cycles of the real estate market are usually longer than the cycles of the economy, they last 18 years on average, although the natural rhythm of the process has often been upset by different outside factors, such as economic depressions, wars and technical revolutions. The housing programs of the government and the changes in the international financial market have also significantly influenced the length of the different periods.

Cycles in the housing market, as cycles in the economy, also have four components, and the former follow the latter with certain delay. The process usually culminates in a certain measure of *surplus construction*, resulting in decreasing demand, sales prices and rents. At this point, constructions come to a halt or slow down to a large extent. This corresponds to the depression period in the cycle of the economy) and *the gap* between supply and demand *starts to disappear* and then comes *a state of equilibrium*, when supply and demand correspond to each other, and both the sales prices and the rents reach a normal level. The final stage is that of *developments*. As the economy returns to a period of growth, employment, incomes, sales prices and rents all start to increase. Demand significantly rises in these periods and constructions start in order to satisfy it.

Besides the delay, there is also a difference in the connection between the cycles in the real estate market and the general cycles in the economy, which is manifested in the level of performance. At the time of a boom, the housing market flourishes all the more, while at a time of a recession or a crisis the situation in the housing sector is even worse than in the other sectors of the economy. While at a time of growth, there are high rents, large-scale developments, intense financial transactions and a large number of new constructions in the housing market. As a consequence of economic recession the losses in the housing market are unproportionally large, sales prices and rents fall sharply, developments slow down even more than they should and the same is true of financial transactions as well. An example of this is the Great Depression in the 1930s, when production fell by 20 to 50 in the other sectors of the economy and recession in housing construction was more than 80 percent.

SECTOR-SPECIFIC PROBLEMS

Housing construction as a priority in housing policy

It is doubtful whether new construction should have a priority in housing policy after quantitative housing shortage has been abolished. Of course, it is in the interests of influential lobbies within the economy and traditional housing policy has also preferred the brick and mortar type of subsidies. It took a long time in West-Europe as well until the system accepted a subsidy policy attached to incomes and housing consumption. Housing construction is important and, as we have seen, it is a natural phenomenon in a healthy economy. In Hungary there is serious structural housing shortage (there is a large number of units the quality of which is not acceptable), and this could be helped through new construction and renovation. Housing construction cannot be started artificially. Subsidies make up maximum 10 to 15 percent of the total amount of the costs of the development and it would be an illusion to rely on them to start housing developments. As we will see, only the subsidy and not the number of decisions to start housing investment influence the timing of the decisions the households make. Badly structured subsidies cause more harm than good.

The number of new constructions has dropped significantly, while in 1987 it was 57 thousand it reached the lowest point in 1993 and 1994, when 21 thousand units were constructed, and by 1996 there was a slight increase with 28 thousand new constructions. The proportion of constructions financed by the government or the local council or local government dropped sharply: in 1987 14 percent while in 1996 only 1 percent of the units was constructed by local and central government institutions. The households have taken over the role of not only of government organs but that of other business enterprises and companies as well. While in 1996 only half as many units were built as at the end of the 80s, self-help constructions by households dropped only by 20 percent, so the proportion of units built by natural persons was 92 percent in 1996? The change in the background of builders was accompanied by a change in construction technologies and forms of

constructions.

Table 4
The change in the volume and the parameters of housing construction

Year	The number of construction permits	The number of units constructed	The number of units demolished	Average size (m2)	Proportion of self-help construction
1980		89,065	17,978	67	37.2
1985		72,507	12,490	79	52.0
1990		43,771	7,435	90	69.8
1991		33,164	5,471	90	73.4
1992	24,057	25,807	4,540	93	79.4
1993	20,245	20,925	4,505	95	86.3
1994	27,152	20,947	5,067	97	86.5
1995	39,053	24,718	6,423	99	91.4
1996	30,462	28,257	6,584	97	N/A
1997	30,474	28,130	6,959	95	N/A

Source: Central Statistical Office, Housing Statistics Almanachs

An accepted argument: at least 40,000 units per year must be built, because if we only replace the loss in the housing stock, then calculating with a 100-year life-span, approximately 1 percent of the stock has to be replaced and this means 40,000 units per year. Furthermore, since 1991 housing construction has been below 40,000 and if we want to make up for that as well, 40,000 is only a moderate estimate. This argument is not valid, because:

The new units are much more valuable than the existing units, let alone the ones due to be demolished (e.g., the value of a new unit is approximately three times as much as that of an old one, so the stock is replaced in value).

It is important that the number of households decreases, which means a decrease in the size of the demand as well.

The housing stock is not so old as it is supposed by the argument.

Black economy and housing policy

One of the most serious obstacles in the modernization of the economy and the society is the gray and the black economy. The housing sector also enjoys the short-term benefits of black economy (lower construction prices, larger supply, lower rents in the private sector, etc.), but the price to be paid is very high (unforeseeable market, the lack of guarantees, etc.). It is an important goal in housing policy to reduce black economy, which can be considered as an important condition of joining the EU. However, this can only be

achieved if it takes place simultaneously in the other sectors of the economy, otherwise it only aggravates the crisis in the housing sector.

When interpreting the data, the difficulties involved in measuring the income of the households through surveys must obviously be considered, including the fact that incomes from the black economy are difficult to register. According to expert estimates, the performance of this sector was around 30 percent of the GDP.

Owners sector or rental housing sector

The distorted ownership composition of the housing stock is one of the most serious problems in the current Hungarian housing sector, the harmful consequences of which is recognized only by very few people. The negative impact on the mobility, the more rigid housing market (the lack of the ability for adaptation in the housing market), the difficulties involved in addressing social problems. The generation conflicts (the obligations of the elder generation), the coercive impulse of the young people to buy a home of their own. The leaking away of subsidies (subsidies provided for the owners sector) are all arguments that are not suitable to convince housing policy makers grown up to be naturally opposed to the rental sector. European comparisons are also of no use against the economically unjustified statement that it is *more expensive* to keep up a rental flat. After the privatization of rental units, it would be, of course, very expensive to create a new rental housing sector, but long-term housing policy must take into accounts the social costs caused by the lack of a modern rental housing sector.

The housing systems of the EU have gone through very different historical development patterns, which of course, resulted in different institutional systems. Despite the differences, two inevitable conclusions can be drawn from the comparison:

The proportion of rental units is very low

The proportion of social rental units is also very low

If Hungary wants to implement a modern housing policy, it cannot neglect these facts. This statement is often considered to be relative, on the grounds that comparison with more developed countries is not justified, or saying that the system of other countries is not to be copied mechanically and finally because there are exceptions among EU countries as well.

It would be well worth devoting a more comprehensive study to this issue, but instead we have to confine ourselves to a few short statements. These statements are even truer concerning the ownership structure in housing in the earlier stages of development in developed countries, when rental housing sector was even larger. Although well-developed systems established in developed countries cannot be mechanically adopted, the economic and social factors, which played a role in forming these structures, must be considered and it is at least worth considering alternative solutions among Hungarian

conditions. Finally, it is worth looking at the possible causes of the low level of the social sector in different countries, because there are certain arguments to the effect that these different cases suggest a similarly distorted structure as the one in Hungary.

Table 5
The composition of the housing stock in EU countries, 1995

	GDP/per	Private	Rental unit		Total	Other
			Private rental	Social rental		
<i>Private rental sector larger</i>						
Switzerland	36,430	31	60	3	63	6
Germany	26,000	38	36	26	62	
Luxembourg		67	31	2	33	
Belgium	22,260	62	30	7	37	1
<i>Social rental units larger than</i>						
Holland	21,300	47	17	36	53	
Austria	25,010	41	22	23	45	14
Sweden	23,270	43	16	22	38	19
Denmark	29,010	50	24	18	42	8
France	23,550	54	21	17	38	8
<i>Private ownership unit larger</i>						
Ireland	15,100	80	9	11	20	
Spain	12,500	76	16	2	18	6
Finland	20,410	72	11	14	25	3
Greece	8,400	70	26		26	4
Italy	18,400	68	20	5	25	7
UK	18,950	66	10	24	34	
Portugal	6,900	65	28	4	32	3
Norway	26,590	60	18	4	22	18
<i>EU average</i>						
		56	21	18	39	5
Hungary		91	2	6	8	1

Source: Balchin, 1996

A housing policy based on the modern theory of economics is in favor of a neutral subsidy and taxation policy concerning the forms of ownership. This means that there is no reason to think that resident ownership (when the owner lives in the unit) is better than rental housing. In the housing policy of West-European countries after the Second World War there was a tendency towards a taxation and housing policy supporting resident ownership, which led to the present ownership structure. There were political much rather than economic reasons behind this housing policy.

The present Hungarian resolutions are clearly against rental housing. The subsidies received by the private sector (housing construction subsidy, interest subsidy, local grants, employer s grants) and the tax allowances (the purchase of private units, allowances after

savings, imputed rents³) all contribute to a situation where it is more expensive to rent than to buy or construct a unit. This leads to an economically distorted system and a distorted use of the resources of the society. The distorted regulations of not only the demand but the supply (the investors) also make it more disadvantageous to invest in rental housing. Investors in rental housing must face systematic disadvantages, mainly the legal regulations and the inappropriate management of the risks - default, high depreciation, unpaid bills, etc. So, it is by no chance, that practically there is no private rental sector in Hungary. Even well informed housing policy makers are content in stating that Hungarian households cannot afford to pay the rents in the private market but they fail to come to the conclusion that this is mainly due to the housing policy regulations.

A larger rental housing stock would decrease the demand for subsidies to private units and would help to form a more balanced system of housing subsidies.

Housing mobility is hindered by the too large sector of owners, which works against a transformation in the structure of the economy as well. Through the analysis of the Polish housing system it was proved that 15 percent of unemployment is caused by the lack of the rental sector. The most recent analysis has found an obvious link between unemployment and the lack of rental units.

Another argument against rental housing that can often be heard is the cost of operating or keeping up the rental units. This is, no doubt, an exaggeration, especially if we compare the cost of upkeep in a multifamily rental block and a privately owned detached house. The real difference is in the maintenance costs and particularly in the careful monitoring of the condition of the building, the immediate repair of the faults and careful attention paid to the environment.

Let us consider first the choice between private ownership and rental housing. Choosing a home is not a decision in the life of a family, which is once and for all, but one that can be modified later several times depending on the circumstances and the life cycle of the family. In the practice of market economies, the proportion of households having their own flat or house is in linear proportion with the age of the members. That is, acquiring their own property is the outcome of changes in the financial conditions and/or residence of the family and not a choice forced on them. For households at the beginning of their career, which are more inclined towards mobility, rental housing is more suitable both for financial considerations and both because children may be born to them.

The social targeting of the system of subsidies (leaks)

The basic issue of the system of subsidies in view of the current political debates is whether it should be based on policy concerning the society or social policy. Everywhere in

³ Imputed rents mean that the owner of the unit does not pay taxes after the utilization of his or her property as a residential unit, in contrast to the household renting his or her flat.

the world there is a mixed system and the issue is that of the emphasis. The macro-economic conditions, we think, do not justify an orientation towards policy concerning the society, but there are a lot of influential interests in favor of it (construction, housing savings cooperatives, etc.). One of the aspects in analyzing the subsidies is whether housing investment increases owing to the subsidies (at the targeted layer, if there is such), or not and the subsidies are leaking away to another sector (consumption).

One of the key problems of the system of subsidies is the extent in which resources leak away to other areas. This can have very different mechanisms and causes. One of the typical causes is that market institutions are not set up or do not operate properly (market failure). For example providing an interest subsidy, in case there are no competing banks, can raise real interest rates, so the subsidy reaches the beneficiaries only partly. Or a certain part of the subsidies provided through housing savings banks are used to operate the system of institutions itself and in this sense is leaking away. In a similar way the subsidies provided for the households can have two types of impacts:

They may increase the housing expenses of the household, or at least, the amount used for this purpose is not decreased.

The subsidy makes it possible to use the income of the household for other purposes. Here the subsidy again only partly contributes to the achievement of the target set within the society. In debates on housing policy, they often use this argument, but many times in a wrong way. Leaks cannot be wholly excluded but the possibilities are different in the case of each subsidy.

One of the most important principles of operating the systems of subsidies is that the distribution of subsidies should take place while exactly determining the *eligibility criteria* (targeting). When deciding on the eligibility, the income (financial) criteria should be taken as primary. The experience of the Central Statistical Office survey studying the social composition of the people receiving social subsidies support the statement, based on an assessment of the eligibility concerning the income, that it is possible to operate these systems. (This is also justified by the experience gained in linking the family allowance to incomes).

Experience shows that the system of municipalities is the most effective agent in operating the system of subsidies, if there are certain centrally defined criteria built in the system. The above-mentioned study also showed that the local government at certain intervals defined by decree checks the eligibility for the regular forms of provision. This is supplemented by a study of the environment, through which the living conditions of the applicant are examined and they try to collect information on whether there is any income not reported.

When using the targeted subsidies, efforts should be made to find the most effective solution appropriate for the local housing market conditions (cost efficiency). In villages the

solution is private ownership and not necessarily rental housing, but in cities rental units are the best solution, which is also clearly justified by international experience.

Eligibility must be measured increasingly through income factors and the existence of black economy cannot be a valid argument against their use. The local governments are the most suitable agents for the operation of systems, which consider the incomes. The successful practice of the system used to deal with the applications for the distribution of units also shows that in the case of the social layers applying for a social unit, the filter connected to the income is effective and the rarely occurring negative cases *do not influence the efficiency* of the system.

One of the dilemmas of the systems for housing subsidies, and subsidy systems in general, is that how targeted the subsidies are. The debate essentially goes back to the 80s, when the argument for connecting social policy subsidy to the number of children was that it expresses the social situation the best, because the higher the number of children, the lower the income per capita. In the middle of the 90s, however, the differences in the income increased.

The system of housing subsidies in the 70s and 80s was based on the equal distribution of incomes. The differences in the incomes of the families were relatively small and depended mainly on the number of the children, while by the 90s the differences in the incomes have radically increased and income from work and the activity in the business sector became increasingly important factors. Although the income per capita in the households with children is lower on average than in households with no children, within this group we have to count with increasingly high differences in the income as well. Two conclusions can be drawn from the above: first, the proportion of targeted subsidies must be increased and second, incomes have to be increasingly considered when distributing the subsidies.

The systems of housing subsidies have gone through considerable changes in the West-European countries in the past few decades. On the basis of these changes a few basic principles for an effective program of subsidies can be formulated:

Targeted versus non-targeted programs. Non-targeted programs, which could also be called boom subsidy programs, are very difficult to justify, because taxes have to be allocated to ensure their operation and they can be politically justified if the costs of generating the surplus tax revenues are smaller than the results (new construction and multiplier effect). This is a subject of intense debates and this instrument should be used when the opportunities offered by the market have already been utilized. Developed countries have clearly taken steps towards targeted programs and there are only few non-targeted programs, which have not totally disappeared only because of political reasons.

Cash subsidies versus interest subsidies on loans. Cash subsidies are more

efficient, because they can be better calculated, both for the beneficiary and for those disbursing the subsidy. In an economic environment with a high rate of inflation interest subsidies are not efficient, because it is not possible to tell exactly what the real value of the subsidy is. Another problem with interest subsidies is that they distort market conditions, because they can easily lead to an increase in real interest rates (especially in the case of housing loan systems that have a virtual monopoly).

Budgetary versus extra-budgetary subsidies. An argument against extra-budgetary subsidies (e.g., tax allowances or preferential prices for vacant lots on the local level, etc.) is that they cannot be calculated or can only be calculated and supervised with difficulty.

Capital subsidy (for the acquisition of units) versus current (housing maintenance) subsidy. The problem with capital subsidies is that targeting is more difficult to ensure and once disbursed, it cannot be revoked.

Programs, of course, can only be assessed if information is available on the basis of which the efficiency of the use of the subsidy can be evaluated. This is hardly possible at present. The criteria for efficient subsidies:

The conditions for the subsidy must be widely known, the applicants should be able to see the conditions and the criteria clearly.

The participants should be able to calculate the size of the subsidy, and the impact of it should be clearly foreseeable for both sides.

The subsidy remains confined within the circle of those who are targeted, that is, it is distributed according to the intentions of the program.

The role of the local governments in housing policy

It is important to increase the role of local governments in housing policy. The housing policy of the central government should also take a turn in this direction, making it possible for the local governments to decide on the use of their own resources and the centrally allocated or supplemented resources independently. Housing policy at the local government level has promising opportunities, but only if the re-distributive effect of the programs is limited and the use of the subsidies is suitably monitored. The lack of the two above-mentioned conditions largely restricts the efficiency of the present local government programs.

The 1990 Law on Local Governments laid a new foundation for the Hungarian system of local governments. Despite the well-known and often exaggerated difficulties of the transition, local governments should have an increasingly important role in actually formulating the housing policy of the central government. Beside international experience

(decentralization in the public administration, cooperation of public administration and private organizations), this is also justified by the fact, that local governments are able to find more effective solutions both from the side of the demand and the opportunities if there is *a suitable system of incentives*.

As a consequence of what has been said in the introduction, local governments cannot properly perform their role of providing social housing, which has different explanations:

As a result of privatization, the housing stock available for social housing management is unproportionally small. The problem is aggravated by the fact that the private rental sector in the large cities is not significant yet, prices are high and therefore it offers no supplementary selection in the rental housing market for the households with a medium or low level of income.

The only way for the local governments to provide housing in the cases when they are legally obliged to (besides abolishing forced co-tenancies) is to make use of the vacant stock. This means very narrow opportunities and justifies the expectations to extend the opportunities for constructing rental housing or buying units for rental purposes on the second hand market in small communities.

In Hungary the selection of social housing available has become quite narrow, owing to housing privatization the local government housing stock has been reduced to 5 percent. Calculating with a 1-percent vacancy rate, results in an average of 4,500 units per year for distribution, which makes up 3 to 6 percent of the total number of transactions. In 1980 24 thousand, while in 1988 21 thousand vacant rental units were allocated by the councils, which makes up 2.5 to 3 percent of the housing stock. By 1992 the number of vacant units dropped to 9 thousand, which means that now approximately 4 to 5 thousand units can be distributed. On the basis of all these, about 5 to 15 percent of those in a socially disadvantageous situation can hope to receive a local government owned unit, 85 and 95 percent of them have to find a unit in the market. If we consider the other tasks of the local governments as well, which are not necessarily related to those who are in a socially disadvantageous situation, it will be clear, that the local governments will not be able to perform this task with the instruments available.

The remaining local government housing stock is in such a bad quality and its upkeep and renovation is so difficult that this, especially in certain parts of the capital city but in a few other cities as well, involves the danger of segregation and the formation of slums. Although 90 percent of the local governments with a housing stock of 10 or more units formulated their decrees in 1994. After that, the narrow opportunities for local government housing management is indicated by the fact that at the end of 1996 the monthly rent per square meter in units with

full comfort was 48 forints on national average. In the case of an average, 54 square meter local government unit, this means 2,600 forints per month, which obviously shows only what the tenants are able to pay and bears no relation to the actual costs of keeping up the units.

Most of the local governments have not set up an information system to register the needy on a reliable basis and to update the information. In several cities, mainly in county seats, the local government is making continuous efforts to create certain records, but these do not involve continuous monitoring, so the new applicants and the ones who have received a unit cannot be monitored and information on the needy cannot be updated. The increasing tensions in the situation of the capital city is indicated by the fact that at the end of 1996 only 5 district governments were keeping a record of any sort on the applicants.

Housing policy allowance

At present, the housing policy allowance is the largest item in the budget related to current housing investments. This subsidy has been criticized for a long time and we think that it is expensive and it has caused considerable harm. The transformation of the housing policy allowance is one of the most areas where the government has an opportunity to take steps.

Housing policy allowance, which was called social policy allowance before 1994, is one of the most important instruments within the present system of subsidies. A positive aspect of the subsidy is that the households receive it in cash, so the size of the subsidy is clear both for the households and for the central budget and the advantages and the costs can be seen at once. (The actual size of the interest or repayment subsidy also depends on the rate of inflation, therefore it is a much less efficient instrument, because the recipients usually underestimate the size of the subsidy.) Housing policy allowance was attached to housing construction financed by the government at first (from 1971) and in 1982. It was extended to private construction of houses, but it has always been confined to new construction, except organized housing construction, and construction by enterprises when the subsidy was also extended to the purchase of existing units related to the newly constructed one.

The contradictory character of the subsidy became more evident at the end of the 80s, when the number of new constructions dropped. The prices became several (four or five) times as much as they had been and the differences in the incomes also increased: consequently subsidizing new construction meant subsidies for the more wealthy social groups. The subsidy became regressive in its character and worked against the intentions to make housing policy subsidies more targeted socially. The social policy component was the criteria concerning the number of children; this factor, however, made a difference only among households in a better financial situation, which could afford new construction. In 1994 there were essential changes and even the name of the subsidy was changed from social policy allowance to housing construction allowance, which indicated that it was

mainly intended to facilitate new construction. The size of the subsidy was increased and the differences considering the number of children also became larger: the size of the subsidy grew significantly in the case of families with two children and even more in the case of three children. The decreases in housing construction stopped and in 1995 and 1997 there were nearly 30 thousand constructions. The total amount of housing construction subsidies exceeded the estimates substantially, while it was only 6 billion HUF in 1994, in the following three years it went up to 37, 31 and 32 billion HUF. In 1995 the eligibility criteria concerning the size of the units were made stricter by the government and subsidies for the chains of old units attached to the new construction were also abolished. (Subsidies were provided for only one attached unit.)

In the expert committee there was agreement on the need to introduce a new subsidy beside the present housing construction subsidy. The present volume of new constructions in itself does not justify an increase in the government subsidy and because the efficiency of the present system is also doubtful. The following arguments support a change:

Although the subsidy contributed to an increase in new constructions, its cost efficiency (the value of the subsidy/the value of new construction) is very low: more than 2 million HUF per new unit.

The social targeting of the subsidy is not good enough. This is because about 10 percent of the 100 to 120 families changing residence in a year receive it. In the secondary market cheaper units are dominant, which households with a lower level of income can more probably buy. Another argument is that those with a lower level of income are excluded because they cannot produce the necessary 35 percent of their own capital (apart from the frauds to be discussed later). Owing to inadequate monitoring we can only suppose that the really needy families will not receive the subsidy.

Problems in the regulations provided incentives for frauds and according to experience, especially in underdeveloped areas, resulted in the wide use of poor quality materials and bad workmanship.

As the allowance is attached to new units only, it does not effectively help to solve the housing problems of families, ignoring the fact that extension or purchasing an old unit is, in many cases, a cheaper and more cost efficient solution.

The housing policy allowance does not have an influence on one of the most acute problems of the housing system, the deterioration of the multifamily stock. The size of the problem is well indicated by the fact, that renovation needs amounted to 120 billion HUF at 1994 price levels, according to conservative estimates and actually only 60 billion HUF is spent on renovation. Condominiums and housing cooperatives are responsible for 75 percent of this deficit. At the same time the

high level of energy consumption in multifamily blocks (especially in the ones constructed through industrial technologies, is also a big problem, which is due to the outdated heating systems and the low level of heat insulation.

Housing savings banks

Setting up the housing savings banks have been the most important change in the past few years, because an institution was formed, which keeps the budget under permanent pressure and has significant capacities to assert its interests. Increasing budgetary expenditures have to be expected, which would be justified not only by a natural growth of the system (the growth of the number of new members), but also by the lack of this growth. (It is a bit like the agricultural subsidy: if the weather is good, it has to be subsidized because of it and if the weather is bad then because of it). The system retains its operational ability through the continuous flow of new members, who practically co-finance the loan. Since the basic motivation in the system is the favorable form of savings (not housing purposes), therefore the system is very sensitive to the competition in the market of savings.

There are very different estimates on the impacts of housing saving banks. There is no real information on who take part in the scheme (what income groups) and on the impact it will have on the housing market. It will replace the former schemes of preliminary savings. According to the 1996 Law on Housing Savings Banks, the subsidy is 40 percent of the deposits. Not more than 36 thousand forints for the first year in the case of contracts made before the end of 1997, and later it is 30 percent of the deposits placed in the given year but not more than 36 thousand forints. When submitting the law on housing savings banks, the proposal expected 100 thousand accounts a year. Now we can expect 250 thousand contracts by the end of 1997 (in about half a year), which is five times as much per year as the figure in the proposal of the Finance Ministry. We propose that the amount of subsidies should be nominally fixed and that no attached tax allowances should be introduced.

The setting up of housing savings banks was maybe the most disputed step taken by the government. It was clear for everyone, that some of the subsidies provided through the housing savings banks will be received by people who would invest in their units even without government assistance (modernization, smaller renovations). This means that this subsidy, the total amount of which is probably high, although the amount received by one household is small, will partly be used in other areas, just as the former subsidies were. Furthermore, this subsidy does not fulfill the widely accepted criteria of targeted subsidies provided for the needy. Subsidies through the housing savings banks are typically regressive, which favor the households with a higher level of income. When submitting the law on housing savings banks, the proposal expected 100 thousand accounts a year. At this point, we can expect 250 thousand contracts by the end of 1997 (in about half a year), which is five times as much per year as the figure in the proposal of the Finance Ministry.

The social housing problem

A negative phenomenon in the housing policy in the past 8 to 9 years has been the lack of addressing the social housing problem. Neither the local governments, nor the central government have been able to take effective steps in this direction. They kept postponing dealing with the issue, partly because the system of subsidies had not been worked out, the level of supervision was low and institutional interest were totally lacking. The system of subsidies must be radically reformed and the regulations concerning the local governments must be modified in order for changes to take place in this area.

Until 1989 housing expenses were heavily subsidized from the central budget, as the experts put it the housing expenses (and the cost of acquiring a unit) are not built in the wages. Housing expenses amounted to 10 to 12 percent of the income of households in general. Poverty was an existing phenomenon, but it was rather the consequence of the lack and the irregularity of income and the consumption habits of the households than the amount of the housing expenses. As subsidies were provided for the price of energy, the utility fees (water, sewage, and waste collection) from the central and the local government budget, both the consumers and the utility companies were wasting the resources. The problem of measuring consumption at the household level and that of the effective collection of fees remained unsolved for decades. An obvious consequence of the change in the political system was the rise in the housing expenses, the extent of which, as companies usually have a monopoly in the market, is a subject of intense social debates. The rise in the fees was different in different areas depending on the ownership structures and the different institutional interests.

Housing expenses have radically risen in the past 6 and 7 years, while the real value of the incomes is decreasing and the differences in the incomes have increased. As a result, housing expenses are 25 to 30 percent of the income of households on average, which, in the case of the lower income fifth can be near 45 to 50 percent. While housing expenses have been growing, the transition has been even more difficult because:

Financial burdens were not equally distributed among the different types of buildings, which influenced the market value of the units and consequently the wealth of the households.

The households did not have the same opportunities to accommodate to the increasing financial burdens, where it was possible to measure consumption, the households flexibly reacted to the changes (e.g., single-family houses), in other places it was not possible to accommodate (e.g., through the reduction of consumption).

Charging and collecting the fees was very different in the different communities and in the case of the different services and it is still a problem (e.g., arrears).

In Hungary homelessness is a new phenomenon, which is mainly not a housing problem so much but a social and health care problem. The housing system before the change in the political system, concerning the given problem, was characterized by basically low housing costs. A wide range of licenses for tenants in the rental sector, very difficult conditions to acquire units (high sales price/income ratio and a long period of waiting for the flat). At the same time it rarely happened that people lost their home and were dumped to the street. A specific characteristic of the housing situation was that the costs of acquiring a home were increasingly placed on the family background, therefore families with no background were in an especially difficult situation. Solving the social problems is even more difficult owing to the distorted ownership structure of the Hungarian housing system:

The proportion of rental units is extremely low.

The proportion of social rental units is also very low.

In the past 15 years the most important change in the rental housing sector was the privatization of *municipality owned units*. The 1980 local government rental housing sector made up nearly 25 percent of the total housing stock, and by 1996 it became as low as 6 percent. The figures clearly show that the housing stock is characterized by a distorted ownership structure, which is indicated by the low proportion of rental units and the total lack of social units. International comparison clearly proves that the proportion of the rental stock (social and not social) is much higher in the housing sectors of more developed countries. The figures of the 1996 *mikrocenzus* survey clearly show that the worst quality units remained in local government ownership, as indicated by the time of construction, the level of comforts and the base area. Figures in Budapest⁴ show a significantly larger difference:

The value of the units the occupants of which do not intend to buy their home is 40 percent lower than that of the units already privatized.

Units on a special list, not allowed to be sold, remain in local government ownership, they are in comparatively better condition: the difference is 20 percent.

We can draw similar conclusions based on the income of the household.

The stock, the sales and the proportion of local government ownership units

Region	Local government ownership units	Units sold in the percentage of the local government	Local government ownership units in the percentage of

⁴The source of the figures is the 1,000 Budapest sample from the beginning of 1995. The basis of the sample is a stock of 1,000 units, which were in local government ownership in 1990.

			housing stock at the beginning of 1990	the total housing stock at the beginning of 1997
	Stock 1990 I. 1	Sales 1990 to 1996	Stock 1997. I. 1	
	In thousands			
Hungary in total	721.3	513.3	208.6	71.2
Budapest	395.8	282.0	114.2	71.2
				5.2
				14.0

The social problems of the housing system have intensified in the past few years; the main reasons were the following:

Owing to housing privatization, the housing stock which potentially could have served social functions was transferred from the public sector thereby increasing social inequalities and about 100-150 thousand units were left out of the approximately 800 thousand in the original stock.

The housing law did not facilitate the formation of a modern rental housing sector but kept several rules from the old system while providing a larger extent of independence for the local governments.

The transformation of the system of housing subsidies is contradictory:

The housing maintenance subsidy has not been suitably emphasized but it remained a neglected part of both the central and the local housing policy.

The system facilitating the acquisition of homes and the housing construction subsidy system has not been transformed either and the new parts mainly serve the interests of the middle class.

The lobby interests behind the new programs are only sporadically mixed with social elements (habitat for humanity, etc.).

We must be prepared to see an increase in the trends that may result in a growth of the number of social problems and that of homeless people without the formation of a suitable social system. This is basically due to a rise in the housing expenses owing to energy and utility costs that has made the housing expense/income ratio intolerably high (the growth in the rents contributed to this tendency only to a smaller extent). The accumulated arrears are increasingly high and there is a danger that effective methods will be used to collect these arrears. The issue of collecting the arrears is like a bomb with timing now, which the local governments and the companies are trying to hide and to finance relying on central allocations and fees. This is very dangerous practice, which removes the solution even further. We should clearly see that there are several factors involved in the issue of arrears:

Utility systems were created that were not cost sensitive and as companies had to enter the market, in order to survive they charged so high fees that people could not afford to pay. It was basically by chance that households were the customers of a particular company and their consumption cannot influence the price or can do so only to a small extent. (For example district heating companies).

The other main reason behind the arrears is that the operation of the companies is not efficient enough (collecting the fees is not efficient) and they make the households pay for these extra costs in the fee.

In most cases it is not possible for the consumption of the households to be adjusted to the changes in the price, as there are no individual meters, etc.

The accumulation of the arrears is partly related to the willingness to pay, that is, there are certain households, which would be able to pay, but as there are no sanctions in the case of default, they prefer not to pay (the problem of free riders).

The sudden rise in the household expenses (energy costs, but in a limited sense the arbitrary change in the conditions of old OTP loans was also an example of this).

In Hungary the selection of social units available has become increasingly limited, as after housing privatization the municipality housing stock was reduced to 6 percent. Calculating with a 1-percent vacancy rate, results in an average of 4,500 units per year for distribution, which makes up 3 to 6 percent of the total number of transactions. In 1980 24 thousand, while in 1988 21 thousand vacant rental units were allocated by the councils, which makes up 2.5 to 3 percent of the housing stock. By 1992 the number of vacant units dropped to 9 thousand, which means that now approximately 4 to 5 thousand units can be distributed . On the basis of all these, about 5 to 15 percent of those in a socially disadvantageous situation can hope to receive a local government owned unit, 85 to 95 percent of them have to find a unit in the market. If we consider the other tasks of the local governments as well, which are not necessarily related to those who are in a socially disadvantageous situation, it will be clear, that the local governments will not be able to perform this task with the instruments available. The demand for social housing, based on the secondary information available, can be estimated to be at least 15 percent of the housing stock, and even with a social housing stock of this size we would be below the average of the EU.

The estimations about the social housing needs are extremely unreliable and we may take a few steps towards answering the question and finding the possible solutions if we try to define the demand and the typical situations more clearly. We can distinguish between the following types:

People falling behind in the lowest social layer. These are families, many of them young and with children, who find themselves in a disadvantageous situation, unemployed or among unacceptably low-income conditions. Whether they live in rental units or in privately owned units, they are in danger of losing their home because they are in arrears and the system of housing subsidies can either provide them with help or not.

Young households, with no support from their relatives and with no wealth accumulated by the former generations. Households at the beginning of their career are in a nearly hopeless situation without any support from the relatives, they are excluded from the transfer of wealth between the generations, drifted to and permanently stranded in lodgings and in the rental market. Only a few of them are able to overcome these initial handicaps.

Temporary disadvantages and difficulties in adaptation. In the different life cycles households have to face serious difficulties in adaptation, losing their home among them, if for example they get a divorce or if they move to another town because of unemployment in the town they live in.

The role of housing loans. This is the critical point in the Hungarian housing system. Housing lending and in this sense housing finance plays an increasingly partial role, the cause of which is not seen clearly by the experts. Some of the experts think the emphasis is in factors within the system of financing, such as high real interest rates, a low level of solvency, high credit risk, the lack of competition, no careful planning in the system of subsidies, etc. Others, including myself, beside these factors also emphasize the macro-economic and macro-housing market relations. The inflation, the decreasing housing consumption, the disappearance of the speculative housing demand, which is now enters the market as supply and the relative decrease in the housing prices, according to which housing investments have a negative yield concerning the whole of the household sector. This means that from the point of view of a typical household housing units are not investments with a positive yield, but consumption and the role of credit has been (and still continues to be) judged from this aspect and it is found to be too expensive.

One of the obstacles in the way of housing mobility is the lack of modernization in the housing finance system. In 1988 the total housing loan portfolio was 300 billion HUF, in 1995 it dropped to 200 billion, which means that the real value of the housing loan portfolio in the economy fell below 15 percent of the 1990 value. An internationally used indicator may cast more light on this problem. It shows the proportion of the housing loans compared to the total loan portfolio, which was 16.8 percent in 1990 and dropped to 8.4 percent. This means that the housing loans of households and their attitude towards the purchase and construction of housing units is not organically connected to the economy.

Why is it, that as the market economy continues to be extended the role of credit decreases in the acquisition of housing units. In western housing systems housing credit may be as much as 80-90 percent of the price of housing units, since it is an investment, which may even serve several generations. Now the proportion of retail housing loans in the total amount of housing investments is below 10 percent. According to Central Statistical Office figures, the households spent 147 billion on housing investments, while the total portfolio of retail loans amounted to XX billion HUF. There are a lot of factors involved in this process: solvency, the difficulty of foreclosure, the high real interest rates (which, by the way, is the compensation for the high risks), etc. It is well worth making a comparison with the automobile market. In 1997 90 thousand new cars were sold, 50 to 70 percent of which were bought with the help of a loan. The credit/value ratio was 70 percent and according to estimates the investments in cars amounted to 220 billion HUF in 1997, which means that they were significantly higher than investments in the housing sector. Is it not so, because the automobile market has a better system of institutions to provide services: information, guarantee, insurance, loans underwriting, etc.

In the market housing systems the purchases (new and old alike) has access to a significant amount of credit compared to the value of the unit, which means a much more effective housing market. This proportion may be as high as 70 to 90 percent, while the proportion of loans in housing investments in Hungary is below 10 percent and according to the figures of OTP, the largest lender in the housing market at present, the number of loans issued show a decreasing tendency.

Housing policy is to be blamed first of all because it has not been able to create the conditions to increase the efficiency of the housing lending system. OTP still dominates the market with a 90 percent share, having inherited this position from the past. Other banks have not yet entered the market, mainly because the government has not been able to provide the background conditions for the launch of safe and reliable lending.

The government modified the system of subsidies for housing loans as of January 1, 1994 and abolished repayment subsidies and introduced 4 to 3 and 1-percent subsidies for the housing loans (under the amount defined in the criteria of eligibility. In the first 5 years there is a 4 percent, in the second 5 years a 3 percent and in the third five years a 1-percent interest subsidy). Considering the present value of the subsidy, the subsidized amount dropped to 10 percent of the loan, compared to the earlier 20 percent. All these have added to a decrease in the loans. The basic issue of housing finance is what hinders the expansion of housing finance:

Solvency surely, but not in a general sense, the demand by the households for cars and their solvency does not prove it for a wide layer.

Credit risk this seems to be the possible explanation; the real problem is that credit risk and the legal system are also problems involving a lot of participants, where

only one participant is enough to block the operation of the system (e.g., Courts or politics).

Transaction costs (underwriting, information system, e.g., Housing prices, etc.) Are too high and they are profitable only in the case of a large volume, which is not possible to provide by one bank.

Competition enters the scene: OTP, housing co-ops, Postabank, K&H Bank, etc., but the interests do not go down, the high interests are probably due to the credit risk. There were attempts at alternative solutions: e.g., customers clubs, products aimed at achieving a maximum amount of tax allowance. The competition is still targeted at the deposits, keeping the clients can be the goal when providing housing loans as well, instead of entering the market and bringing down credit interest rates.

Restoring VAT refund

Restoring VAT refund shows the basic problem of the system of subsidies. The purpose of subsidies is to provide incentives to households who would be present at the market without the subsidies as well, for housing investment. The subsidy (under the current regulations), however, gives everyone the concession, so its impact will be limited. Furthermore, as it has to be financed and supervised (budgetary aspects) this required the exclusion of renovations and extensions, although subsidizing these would be an important goal of housing policy.

Increasing housing construction is made very expensive by the introduction of VAT refund, because, if no filtering is done, increase in the housing sector on the one side is matched by a subsidy enjoyed by everyone on the other. For example, if we choose the more cautious option when 400 thousand HUF/unit maximizes the subsidy, we have to calculate with 40 thousand units, which means 16 billion HUF. And 10 thousand new units match this, that is, the increase is 1.6 million HUF per unit. The 400 thousand HUF per unit limit was in force in 1994, and if we take it at present value, it should be 1 million HUF per unit, which would be 40 billion in total, resulting in an increase of 4 million HUF per unit. The key to the program facilitating construction is to find a way to provide incentives for construction to those who would not build under the present circumstances, without infringing on social justice. This evidently calls for targeted programs, which are complicated from the administrative aspects, but the savings will definitely compensate for the extra costs incurred. Options to limit eligibility: the size of the unit, the value, the income, the size of the family, cities/towns/villages, etc.

VAT refund provides an incentive to officially document the work performed, but only up to the value the subsidy is limited by. If the maximum is 400 thousand HUF, then 2 million HUF worth of bills have to be submitted, which amounts to 40 percent of the average value, leaving out the other 60 percent from the scope of VAT. The other issue is that much of the black economy is about avoiding to pay wage taxes, which are

significantly higher than the 25 percent VAT. It is still to be seen whether the subsidy provides incentives in this direction. One thing is sure: we must be pessimistic about the expected tax revenues.

Housing renovation

There has been significant deterioration in the housing stock in cities (condominiums, housing cooperatives). Although we have no information on the exact measure of it, no one has doubted its significance. The problem is very complex in this area: there are problems of the legal regulations, affordability and financing as well.

The value of the Hungarian housing stock is 6 to 8,000 billion HUF according to expert estimates. In order to upkeep this stock and preserve its value, 1.0 to 1.6 percent of the value of the units should be used. Based on the present value (and not the new construction value), it means that 60 to 128 billion HUF per year should be spent on upkeep to prevent further loss in the value. Taking an average unit at 3 million HUF, it means that a family should use 30 to 48 thousand HUF per year for renovations. This is, of course, not continuous expenditure but it has to pay in the renovation cycles of the buildings. Calculating with new construction value, the amount may even be double. If upkeep/renovation expenses fall behind this level on the long term, there will be a loss in the value of the housing stock.

There are 3.67 million housing units in Hungary, 61 percent of them in private owned single-family homes, 28 percent in condominiums and 3 percent in housing cooperatives. However, only 6 percent of the housing stock are in local government ownership. The quality of the units can be characterized by their level of comfort and by their age.

Three-quarters of the housing stock can be considered to have a suitable level of comfort, but 620 thousand units are without any comfort, which means that still nearly 1.5 to 2 million people live among unhealthy, unsuitable circumstances. A lot of the units with no comfort are in a single-family house or in the local government owned rental stock.

Looking at the age of the housing stock we can say that more than 25 percent of the units were built before the war, 8 percent of them in the last century. The local government owned units are remarkably old: 57 percent of them were built before the war and 25 percent of them in the last century. Most of these buildings are in a bad state of repair owing to the backlog of maintenance and renovations and they need urgent renovations.

Tax allowances

Tax allowances are not significant among housing subsidies at present, but there is a great danger, that this will increase. It has mainly political reasons. Politicians usually prefer to loose some of the tax revenues, rather than implementing programs using the tax collected. This is usually a regressive subsidy; that is, people with higher income receive

more benefit. In the Hungarian system e.g., the tax allowances related to savings or the amortization of housing loans are much more regressive than the allowances for the sale of real estate.

There are different tax allowances. What they have in common, however, is that the terms are in some ways more favorable; it may be an allowance in the calculation of the tax base (attached to either the object or the subject of taxation) or tax concessions (tax deduction or lower rate of taxation). When estimating the size of the subsidy, theoretically we have to find an answer to the question: how much more the revenue of the budget would be if there were no tax allowances. Tax allowances may have positive impacts, such as positive incentives or favorable impact on the distribution of incomes, but there may be distorting effects as well, so we must examine what it would be like without tax allowances. This question, however, is not so easy to answer and we are going to deal with the reasons in more detail. There are three types of the subsidies provided through the system of taxation:

Tax allowance, when the household or the enterprise can deduct certain items of expenditure from the tax base.

Tax exemption, when certain types of incomes are not included in the tax base (e.g., capital gains through the exchange of units are exempted from taxation in many countries).

Tax rate relief, when special rates are applied for certain items (e.g., VAT).

Housing policy makers have been increasingly convinced in the past decade that housing policy should be in favor of a neutral system of taxation. What they mean by this is that the tax liabilities of a household do not depend on how it uses its resources and what is the composition of its consumption, and particularly its housing consumption. This problem can be interpreted in three areas:

Income from housing has to be treated in the same way as income from other business activities or investments. E.g., A unit built by the owner has to be treated in the same way as if the owner constructed a rental unit through a commercial investment and rented it himself) housing as capital investment.

The system of taxation must remain neutral concerning investments (!) As well: housing development should cost as much as any other business investment (e.g., The issue of writing off interests).

The impact of the inflation: the decisions made by households are built on gain from inflation and the related tax rates, so these factors have a distorting impact on the functioning of the system. For example, tax allowance for housing investments provides an incentive for capital gain.

There are different established methods to measure subsidies provided through the system of taxation:

Revenue foregone actual tax revenues are compared with the revenues that the budget would receive if there were no allowances, supposing that the behavior of the taxpayers would not change.

Revenue gain gain in revenues, considering the impact the abolishment of the allowance would have on the behavior of the taxpayers.

Outlay equivalent the size of the indirect expenses of the budget that would be necessary if the tax allowance were abolished in order to ensure that the situation of the taxpayers could remain unchanged.